



6714-01-P

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 324 and 329

RIN 3064-AE30

Regulatory Capital Rules, Liquidity Coverage Ratio: Proposed Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice of proposed rulemaking.

SUMMARY: The FDIC invites comment on a notice of proposed rulemaking (NPR or proposed rule) that would amend the definition of “qualifying master netting agreement” under the regulatory capital rules, and the liquidity coverage ratio rule. The FDIC also is proposing to amend the definitions of “collateral agreement,” “eligible margin loan,” and “repo-style transaction” under the regulatory capital rules. The amendments are designed to ensure that the regulatory capital and liquidity treatment of certain financial contracts generally would not be affected by implementation of special resolution regimes in foreign jurisdictions if such regimes are substantially similar to Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Federal Deposit Insurance Act in the United States, or by the International Swaps and Derivative Association Resolution Stay Protocol that provide for contractual submission to such regimes. In December 2014, the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Board) adopted a joint interim final rule that is related to this proposed rule.

DATES: Comments must be received [insert date 60 days after date of publication in the Federal Register].

ADDRESSES: You may submit comments, identified by RIN 3064-AE30, by any of the following methods:

- **Agency Web site:** <http://www.fdic.gov/regulations/laws/federal/>. Follow instructions for submitting comments on the Agency website.

- **Email:** Comments@fdic.gov. Include the RIN 3064-AE30 on the subject line of the message.

- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.

- **Hand Delivery:** Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Public Inspection: All comments received must include the agency name and RIN 3064-AE30 for this rulemaking. All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/>, including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-I002, Arlington, VA 22226 by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Summary

The regulatory capital rules of the Board, the OCC, and the FDIC (collectively, the agencies) permit a banking organization to measure exposure from certain types of financial contracts on a net basis and recognize the risk-mitigating effect of financial collateral for other types of exposures, provided that the contracts are subject to a “qualifying master netting agreement” that provides for certain rights upon a counterparty default.¹ The agencies, by rule, have defined a qualifying master netting agreement as a netting agreement that permits a banking organization to terminate, apply close-out netting, and promptly liquidate or set-off collateral upon an event of default of the counterparty (default rights), thereby reducing its counterparty exposure and market risks.² On the whole, measuring the amount of exposure of these contracts on a net basis, rather than a gross basis, results in a lower measure of exposure, and thus, a lower capital requirement, under the regulatory capital rules.

The current definition of “qualifying master netting agreement” recognizes that default rights may be stayed if the financial company is in receivership, conservatorship, or resolution under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),³ or under the Federal Deposit Insurance Act (FDI Act).⁴ Accordingly, transactions

¹ See 12 CFR part 3 (OCC), 12 CFR part 217 (Board); 12 CFR part 324 (FDIC). The term “banking organization” includes national banks, state member banks, state nonmember banks, savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Board’s Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C), as well as top-tier savings and loan holding companies domiciled in the United States, except for certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

² See section 2 of the regulatory capital rules.

³ See 12 U.S.C. 5390(c)(8) through (16).

⁴ See 12 U.S.C. 1821(e)(8) through (13). The definition also recognizes that default rights may be stayed under any similar insolvency law applicable to government sponsored enterprises (GSEs). Generally under the agencies’ regulatory capital rules, government-sponsored enterprise means an entity established or chartered by the U.S. government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government. See regulatory capital rules Section 2.

conducted under netting agreements where default rights may be stayed under Title II of the Dodd-Frank Act or the FDI Act may qualify for the favorable capital treatment described above. However, the current definition of “qualifying master netting agreement” does not recognize that default rights may be stayed where a master netting agreement is subject to limited stays under foreign special resolution regimes or where counterparties agree through contract that a special resolution regime would apply. When the agencies adopted the current definition of “qualifying master netting agreement,” no other jurisdiction had adopted a special resolution regime relevant to the definition, and no banking organizations had communicated to the agencies an intent to enter into contractual amendments to clarify that bilateral over-the-counter (OTC) derivatives transactions are subject to certain provisions of certain U.S. and foreign special resolution regimes.

In recent months, the European Union (EU) finalized the Bank Recovery and Resolution Directive (BRRD), which prescribes aspects of a special resolution regime that EU member nations should implement. On January 1, 2015, most of the provisions of the BRRD are expected to take effect in a number of the EU member states. In addition, several U.S. banking organizations have opted to adhere to the International Swaps and Derivatives Association’s (ISDA) Resolution Stay Protocol (ISDA Protocol),⁵ which provides for amendments to the terms of ISDA Master Agreements⁶ between counterparties that adhere to the ISDA Protocol to stay certain default rights and other remedies provided under the agreement. The effective date of certain provisions of the ISDA Protocol also is January 1, 2015. This expected implementation

⁵ See ISDA Protocol at <http://assets.isda.org/media/f253b540-25/958e4aed.pdf>.

⁶ The ISDA Master Agreement is a form of agreement that governs OTC derivatives transactions and is used by a significant portion of the parties to bilateral OTC derivatives transactions, including large, internationally active banking organizations. Furthermore, the ISDA Master Agreement generally creates a single legal obligation that provides for the netting of all individual transactions covered by the agreement.

would generally mirror steps taken in the United States to implement a special resolution regime under Title II of the Dodd-Frank Act.

A master netting agreement under which default rights may be stayed under the BRRD or that incorporates the ISDA Protocol would no longer qualify as a qualifying master netting agreement under the agencies' current regulatory capital and liquidity rules. This would result in considerably higher capital and liquidity requirements.

Accordingly, under this NPR, the FDIC proposes to permit an otherwise qualifying master netting agreement to qualify if (i) default rights under the agreement may be stayed under a qualifying foreign special resolution regime or (ii) the agreement incorporates a qualifying special resolution regime by contract. Through these proposed revisions, the proposed rule would maintain the existing treatment for these contracts for purposes of the regulatory capital and liquidity rules, while recognizing the recent changes contemplated by the BRRD and the ISDA Protocol.

The proposed rule also would revise certain other definitions of the regulatory capital rules to make various conforming changes designed to ensure that a banking organization may continue to recognize the risk mitigating effects of financial collateral⁷ received in a secured lending transaction, repo-style transaction, or eligible margin loan for purposes of the regulatory capital and liquidity rules, while recognizing the recent changes contemplated by the BRRD and banking organizations that have adhered to the ISDA Protocol. Specifically, the proposed rule

⁷ Generally, under the agencies' regulatory capital rules, financial collateral means collateral in the form of: (i) cash on deposit with the banking organization (including cash held for the banking organization by a third-party custodian or trustee); (ii) gold bullion; (iii) long-term debt securities that are not resecuritization exposures and that are investment grade; (iv) short-term debt instruments that are not resecuritization exposures and that are investment grade; (v) equity securities that are publicly traded; (vi) convertible bonds that are publicly traded; or (vii) money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily. In addition, the regulatory capital rules also require that the banking organization have a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent). See regulatory capital rule, Section 2.

would revise the definition of “collateral agreement,” “eligible margin loan,”⁸ and “repo-style transaction”⁹ to provide that a counterparty’s default rights may be stayed under a foreign special resolution regime or, if applicable, under a special resolution regime incorporated by contract.¹⁰

The FDIC requests comment on all aspects of these definitions.

II. Background

A. U.S. Resolution Regime

It is common market practice for bilateral derivatives and certain other types of financial contracts entered into by large banking organizations to permit a non-defaulting counterparty to exercise early termination rights and other contractual remedies upon a counterparty (or a related entity) experiencing an event of default. These contractual provisions are generally recognized as a credit risk mitigant because the provisions allow a non-defaulting party the uninterrupted right to close-out, net, and liquidate any collateral securing its claim under the contract upon a counterparty’s default.

However, as the failure of Lehman Brothers demonstrated, the uninterrupted exercise of such rights by counterparties of a globally-active financial company with a significant

⁸ Generally under the agencies’ regulatory capital rules, eligible margin loan means an extension of credit where: (i) the extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold; (ii) the collateral is marked-to-fair value daily, and the transaction is subject to daily margin maintenance requirements; and (iii) the extension of credit is conducted under an agreement that provides the banking organization with default rights, provided that any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs. See regulatory capital rule, Section 2. In addition, in order to recognize an exposure as an eligible margin loan a banking organization must comply with the requirements of section 3(b) of the regulatory capital rules with respect to that exposure.

⁹ Generally, under the agencies’ regulatory capital rules, repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the banking organization acts as agent for a customer and indemnifies the customer against loss, provided that: (1) the transaction is based solely on liquid and readily marketable securities, cash, or gold; (2) the transaction is marked-to-fair value daily and subject to daily margin maintenance requirements; (3) the transaction provides certain default rights. See regulatory capital rule, Section 2. In addition, in order to recognize an exposure as a repo-style transaction for purposes of this subpart, a banking organization must comply with the requirements of section 3(e) of the regulatory capital rules.

¹⁰ See 12 CFR part 32.

derivatives portfolio could impede the orderly resolution of the financial company and pose risks to financial stability. The United States has enacted laws that impose a limited stay on the exercise of early termination rights and other remedies with regard to qualified financial contracts (such as OTC derivatives, securities financing transactions, and margin loans) with insured depository institutions in resolution under the FDI Act and, in 2010, with financial companies in resolution under Title II of the Dodd-Frank Act.

B. Foreign Special Resolution Procedures and the ISDA Protocol

In recognition of the issues faced in the financial crisis concerning resolution of globally-active financial companies, the EU issued the BRRD on April 15, 2014, which requires EU member states to implement a resolution mechanism by December 31, 2014, in order to increase the likelihood for successful national or cross-border resolutions of a financial company organized in the EU.¹¹ The BRRD contains special resolution powers, including a limited stay on certain financial contracts that is similar to the stays provided under Title II of the Dodd-Frank Act and the FDI Act. Therefore, the operations of U.S. banking organizations located in jurisdictions that have implemented the BRRD could become subject to an orderly resolution under the BRRD, including the application of a limited statutory stay of a counterparty's right to exercise early termination rights and other remedies with respect to certain financial contracts. The BRRD is generally designed to be consistent with the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes),¹² which were initially adopted by the

¹¹ On January 1, 2015, most of the provisions of the BRRD are expected to take effect in a number of the EU member states.

¹² The Key Attributes are available at www.financialstabilityboard.org/publications/r_111104cc.pdf. See specifically Key Attributes 4.1-4.4 regarding set-off, netting, collateralization and segregation of client assets and Appendix I Annex 5 regarding temporary stays on early termination rights. In October 2014, the FSB adopted a 2014 version of the Key Attributes that incorporates new annexes to provide additional guidance with respect to specific Key Attributes. No changes were made to the text of the twelve Key Attributes of October 2011.

Financial Stability Board (FSB)¹³ of the G-20¹⁴ member nations in October 2011, and is designed to provide a standard for the responsibilities and powers that national resolution regimes should have to resolve a failing systemically important financial institution.

ISDA published the ISDA Protocol on November 12, 2014, which provides for amendments to ISDA Master Agreements to stay certain early termination rights and other remedies provided under the agreement. As of November 12, 2014, 18 global financial institutions, including several of the largest U.S. banking organizations,¹⁵ have opted to adhere to the ISDA Protocol and thereby would modify ISDA Master Agreements among those adhering parties. Like other qualified financial contracts, OTC derivatives transactions executed under standard ISDA Master Agreements allow a party to terminate the agreement immediately upon an event of default of its counterparty, including if its counterparty (or a related entity)¹⁶ enters insolvency or similar proceedings.

The contractual amendments effectuated pursuant to the ISDA Protocol would apply the provisions of Title II of the Dodd-Frank Act and the FDI Act concerning limited stays of termination rights and other remedies in qualified financial contracts to ISDA Master

¹³ The FSB is an international body that monitors and makes recommendations about the global financial system. The FSB coordinates the regulatory, supervisory, and other financial sector policies of national financial authorities and international standard-setting bodies.

¹⁴ The G-20 membership comprises a mix of the world's largest advanced and emerging economies. The G-20 members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union. Following the most recent financial crisis, leaders of the G-20 member nations recognized that the orderly cross-border resolution of a globally-active financial company requires all countries to have effective national resolution regimes to resolve failing financial companies in an orderly manner and that national resolution regimes should be consistent with one another. Subjecting the same financial company to conflicting legal rules, procedures, and mechanisms across jurisdictions can create uncertainty, instability, possible systemic contagion, and higher costs of resolution.

¹⁵ As of November 12, 2014, the U.S. banking organizations that have agreed to adhere to the ISDA Protocol are Bank of America Corporation, Citigroup Inc., The Goldman Sachs Group, Inc., JPMorgan Chase & Co., and Morgan Stanley, and certain subsidiaries thereof. See current list of adhering parties to the ISDA Protocol at <http://www2.isda.org/functional-areas/protocol-management/protocol-adherence/20>.

¹⁶ Under the ISDA Resolution Stay Protocol, a related entity is defined to include (i) each parent or (ii) an affiliate that is (a) a creditor support provider or (b) a specified entity.

Agreements between adhering counterparties, including adhering counterparties that are not otherwise subject to U.S. law. The amendments also would apply substantially similar provisions of certain non-U.S. laws, to ISDA Master Agreements between adhering counterparties that are not otherwise subject to such laws.¹⁷ The contractual amendments effectuated pursuant to the ISDA Protocol would permit a party that has agreed to adhere to the ISDA Protocol to exercise early termination rights and other remedies only to the extent that it would be entitled to do so under the special resolution regime applicable to its adhering counterparties (or related entities, as applicable).¹⁸

C. Description of Relevant Provisions of the Regulatory Capital and the Liquidity Coverage Ratio Rules

As noted above, the agencies' regulatory capital rules permit a banking organization to measure exposure from certain types of financial contracts on a net basis, provided that the contracts are subject to a qualifying master netting agreement or other agreement that contains specific provisions. Specifically, under the current regulatory capital rules, a banking organization with multiple OTC derivatives that are subject to a qualifying master netting agreement would be able to calculate a net exposure amount by netting the sum of all positive and negative fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement and calculating a risk-weighted asset amount based on the net exposure amount. For purposes of the current supplementary leverage ratio (as applied only to advanced approaches banking organizations), a banking organization that has one or more OTC derivatives

¹⁷ The provisions of the ISDA Protocol relating to the special resolution regimes in these jurisdictions will become effective on January 1, 2015, for ISDA Master Agreements between the 18 adhering financial companies (as of November 12, 2014). The ISDA Protocol also covers special resolution regimes in other FSB member jurisdictions so long as the regimes meet conditions specified in the ISDA Protocol relating to creditor safeguards, which are consistent with the Key Attributes.

¹⁸ Parties adhering to the ISDA Protocol would initially be contractually subject to the statutory special resolution regimes of France, Germany, Japan, Switzerland, the United Kingdom and the United States.

with the same counterparty that are subject to a qualifying master netting agreement would be permitted to not include in total leverage exposure cash variation margin received from such counterparty that has offset the mark-to-fair value of the derivative asset or cash collateral that is posted to such counterparty that has reduced the banking organization's on-balance sheet assets.¹⁹

In addition, the agencies' current rules permit a banking organization to recognize the risk-mitigating effect of financial collateral for other types of collateralized exposures. Specifically, for risk-based capital purposes, a banking organization with a securities financing transaction that meets the definition of a repo-style transaction with financial collateral, a margin loan that meets the definition of an eligible margin loan with financial collateral, or an OTC derivative contract collateralized with financial collateral may determine a net exposure amount to its counterparty according to section 37 or section 132 of the regulatory capital rules. A banking organization with multiple repo-style transactions or eligible margin loans with a counterparty that are subject to a qualifying master netting agreement may net the exposure amounts of the individual transactions under that agreement. In addition, for purposes of the supplementary leverage ratio, an advanced approaches banking organization with multiple repo-

¹⁹ Under the agencies' regulatory capital rules, the general framework consists of two approaches: (1) the standardized approach, which, beginning on January 1, 2015, will apply to all banking organizations regardless of total asset size, and (2) the advanced approaches, which currently apply to large internationally active banking organizations (defined as those banking organizations with \$250 billion or more in total consolidated assets or \$10 billion or more in total on-balance sheet foreign exposure, depository institution subsidiaries of those banking organizations that use the advanced approaches rule, and banking organizations that elect to use the advanced approaches). As a general matter, the standardized approach sets forth standardized risk weights for different asset types for regulatory capital calculations, whereas, for certain assets, the advanced approaches make use of risk assessments provided by banking organizations' internal systems as inputs for regulatory capital calculations. Consistent with section 171 of the Dodd-Frank Act (codified at 12 U.S.C. 5371), a banking organization that is required to calculate its risk-based capital requirements under the advanced approaches (*i.e.*, an advanced approaches banking organization) also must determine its risk-based capital requirements under the generally applicable risk-based capital rules, which will be the standardized approach beginning on January 1, 2015). The lower – or more binding – ratio for each risk-based capital requirement is the ratio that the advanced approaches banking organization must use to determine its compliance with minimum regulatory capital requirements. See generally 12 CFR part 324.

style transactions with the same counterparty that are subject to a qualifying master netting agreement would be permitted to net for purposes of calculating the counterparty credit risk component of its total leverage exposure. In general, recognition of netting results in a lower measure of risk-weighted assets and total leverage exposure than if a banking organization were to calculate its OTC derivatives, repo-style transactions, and eligible margin loans on a gross basis.

The agencies also use the concept of a qualifying master netting agreement in the current liquidity coverage ratio rule (LCR).²⁰ The LCR rule requires a banking organization to maintain an amount of high-quality liquid assets (the numerator) to match at least 100 percent of its total net cash outflows over a prospective 30 calendar-day period (the denominator). For derivative transactions subject to a qualifying master netting agreement, a banking organization would be able to calculate the net derivative outflow or inflow amount by netting the contractual payments and collateral that it would give to, or receive from, the counterparty over a prospective 30-day period.²¹ If the derivative transactions are not subject to a qualifying master netting agreement, then the derivative cash outflows for that counterparty would be included in the net derivative cash outflow amount and the derivative cash inflows for that counterparty would be included in the net derivative cash inflow amount, without any netting and subject to the LCR rule's cap on total inflows. Recognition of netting may result in lower net cash outflows, and thus a lower LCR denominator and liquidity requirement, than if a banking organization were to calculate its inflows and outflows on its derivatives transactions on a gross basis.

²⁰ The agencies' LCR rules are provided in 12 CFR part 50 (OCC); 12 CFR part 249 (Board); and 12 CFR part 329 (FDIC).

²¹ The LCR final rule provides that foreign currency transactions that meet certain criteria can be netted regardless of whether those transactions are covered by a qualified master netting agreement. 79 FR 61440, 61532-33 (October 10, 2014).

III. The Proposed Rule

The proposed rule would amend the definitions of “collateral agreement,” “eligible margin loan,” “qualifying master netting agreement,” and “repo-style transaction” in the FDIC’s regulatory capital rules and “qualifying master netting agreement” in the FDIC’s LCR rules to ensure that the regulatory capital and liquidity treatment of OTC derivatives, repo-style transactions, eligible margin loans, and other collateralized transactions would be unaffected by the adoption of various foreign special resolution regimes and the ISDA Protocol. In particular, the proposed rule would amend these definitions to provide that a relevant netting agreement or collateral agreement may provide for a limited stay or avoidance of rights where the agreement is subject by its terms to, or incorporates, certain resolution regimes applicable to financial companies, including Title II of the Dodd-Frank Act, the FDI Act, or any foreign resolution regime that is substantially similar to Title II of the Dodd-Frank Act or the FDI Act.

In determining whether the laws of foreign jurisdictions are “similar” to the FDI Act and Title II of the Dodd-Frank Act, the FDIC, jointly with the Board and OCC, intends to consider all aspects of these U.S. laws, including all aspects of stays provided thereunder.²² Relevant factors include, for instance, creditor safeguards or protections provided under a special foreign resolution regime as well as the length of stay.²³

²² See 12 U.S.C. 1821(e)(8) through (13) and 5390(c)(8) through (16). As noted above, the ISDA Protocol covers only resolution regimes that are considered to be consistent with the principles of the Key Attributes. Therefore, it is also expected that any limited statutory stay under foreign law determined for purposes of this proposed rule to be similar to the FDI Act and Title II of the Dodd-Frank Act would also be consistent with the relevant principles of the Key Attributes.

²³ Under Title II of the Dodd-Frank Act, counterparties are stayed until 5:00 p.m. on the business day following the date of appointment of a receiver from exercising termination, liquidation, or netting rights under the qualified financial contract. 12 U.S.C. 5390(c)(10)(B)(i)(I). If the qualified financial contracts are transferred to a solvent third party before the stay expires, the counterparty is permanently enjoined from exercising such rights based upon the appointment of the receiver, but is not stayed from exercising such rights based upon other events of default. See 12 U.S.C. 5390(c)(10)(B)(i)(II).

Without the proposed rule, several banking organizations would no longer be permitted to recognize financial contracts as subject to a qualifying master netting agreement or satisfying the criteria necessary for the current regulatory capital and liquidity treatment, and would be required to measure exposure from these contracts on a gross, rather than net, basis. The proposed rule would allow for continuation of the existing netting treatment for these contracts for purposes of the regulatory capital and liquidity rules. Implementation of consistent, national resolution regimes on a global basis furthers the orderly resolution of internationally active financial companies, and enhances financial stability. Moreover, the development of the ISDA Protocol furthers certain principles of Title II of the Dodd-Frank Act and the FDI Act (in instances where a counterparty is a U.S. entity or its subsidiary) with respect to counterparties who are not otherwise subject to U.S. law.

In addition, the FDIC intends to incorporate the definition of “qualifying master netting agreement”, once finalized, into rules that establish minimum margin requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants (covered swap entities) subject to FDIC supervision. On September 24, 2014, the OCC, Board, FDIC, the Farm Credit Administration, and the Federal Housing Finance Agency published a notice of proposed rulemaking that would establish minimum margin requirements for covered swap entities subject to agency supervision (2014 swap margin NPR).²⁴ The 2014 swap margin NPR would permit a covered swap entity to calculate variation margin requirements on an aggregate, net basis under an eligible master netting agreement (EMNA) with a counterparty. The comment period for the 2014 swap margin NPR closed on November 24, 2014. The OCC, Board, FDIC, Farm Credit Administration and Federal Housing Finance

²⁴ 79 FR 57348 (September 24, 2014).

Agency are reviewing the comments received and drafting a final rule. Ultimately, the Federal banking agencies intend to align, as appropriate, the definitions of EMNA and qualifying master netting agreement in their respective regulations pertaining to swap margin requirements, regulatory capital requirements, liquidity requirements, and lending limits.

In December 2014, the OCC and the Board adopted a joint interim final rule that is identical to this proposed rule.

IV. Request for Comments

The FDIC is interested in receiving comments on all aspects of the proposed rule. In particular, do the amendments to the definitions of “qualifying master netting agreement,” “collateral agreement,” “repo-style transaction,” and “eligible margin loan” ensure that the regulatory capital and liquidity treatment of OTC derivatives, repo-style transactions, eligible margin loans and other collateralized transactions is unaffected by the ISDA Protocol and the BRRD? Is there any reason why the FDIC should not revise the above mentioned definitions?

The ISDA Protocol also provides for limited stays of termination rights for cross-defaults resulting from affiliate insolvency proceedings under a limited number of U.S. general insolvency regimes, including the U.S. Bankruptcy Code.²⁵ The proposed rule does not address this portion of the ISDA Protocol because this portion of the ISDA Protocol does not take effect on January 1, 2015. Instead it takes effect upon the effective date of implementing regulations in the United States. The FDIC requests comment on whether the definitions of “qualifying master

²⁵ Under the ISDA Protocol, upon commencement of such proceedings, adhering counterparties would be subject to a limited stay of their termination rights and other remedies. The limited stay does not apply if a direct counterparty is subject to general insolvency proceedings. The stay also does not apply to payment or delivery defaults or to defaults that are not directly or indirectly related to the affiliate insolvency proceedings.

netting agreement,” “collateral agreement,” “repo-style transaction,” and “eligible margin loan” should also be amended to recognize the stay of default rights in this context.

Question 1: The proposed rule would prevent an increase in regulatory capital by allowing a “qualifying master netting agreement” to include stays that may be imposed by the laws of a foreign jurisdiction as a result of the receivership, conservatorship, or resolution of a foreign financial entity. Given the recent introduction of stays through contracts under the ISDA protocol, as well as in foreign jurisdictions, the FDIC seeks comment on the appropriateness of the proposed rule’s effect on regulatory capital.

Question 2: What was the effectiveness of netting agreements during the financial crisis?

Question 3: How were cross-border netting agreements treated by U.S. and foreign courts?

Question 4: What legal and operational impediments to netting exist today?

Question 5: Does netting of exposures present an accurate reflection of the risk of the underlying transactions and assets covered by this proposal?

Question 6: What criteria should be considered when determining whether a foreign resolution regime or legal framework is substantially similar to Title II of the Dodd-Frank Act and the FDI Act provisions for the insolvency of insured depository institutions?

Question 7: Would the Total Loss Absorbing Capacity requirement as set forth by the Financial Stability Board ensure the presence of sufficient debt that may be bailed in to effectuate the resolution of a foreign counterparty to a U.S. bank as contemplated under the BRRD?

Question 8: What sources are available to provide funding for the resolution of a foreign counterparty to an affected U.S. bank?

Question 9: What length of stay in a resolution regime is appropriate to balance avoidance of market disruption against creditor protection?

V. Regulatory Analysis

A. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), requires an agency, in connection with a notice of proposed rulemaking, to prepare an Initial Regulatory Flexibility Act analysis describing the impact of the proposed rule on small entities (defined by the Small Business Administration for purposes of the RFA to include banking entities with total assets of \$550 million or less) or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. The FDIC believes that the proposed rule would not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of \$550 million or less (a small banking organization).²⁶ As of June 30, 2014, there were approximately 3,267 small state nonmember banks and 306 small state savings associations under the FDIC's supervisory jurisdiction.

The proposed rule is expected only to apply to banking organizations that adhere to the ISDA Protocol, which generally are entities that engage in a substantial amount of cross-border derivatives transactions. Small entities generally would not fall into this category. Accordingly,

²⁶ See 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to \$550 million in assets from \$500 million in assets. 79 FR 33647 (June 12, 2014).

the FDIC believes that this proposed rule would not have a significant economic impact on small banking organizations supervised by the FDIC and therefore believes that there are no significant alternatives to the issuance of this proposed rule that would reduce the economic impact on small banking organizations supervised by the FDIC.

The FDIC requests comment on its conclusion that the proposed rule would not have a significant economic impact on a substantial number of small entities.

B. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the FDIC to use plain language in all proposed and final rules published after January 1, 2000. The FDIC invites comment on how to make this proposed rule easier to understand. For example:

- Has the FDIC organized the material to suit your needs? If not, how could the proposed rule be more clearly stated?
- Are the proposed requirements in the rule clearly stated? If not, how could the proposed rule be more clearly stated?
- Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes would make the regulation easier to understand?
- Would more, but shorter, sections be better? If so, which sections should be changed?
- What else could the FDIC do to make the regulation easier to understand?

C. Paperwork Reduction Act

Request for Comment on Proposed Information Collection

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 through 3521) (“PRA”), the FDIC may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (“OMB”) control number. The FDIC reviewed the proposed rule and determined that it would not produce any new collection of information pursuant to the PRA.

List of Subjects

12 CFR Part 324

Administrative practice and procedure, Banks, banking, Capital adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

12 CFR Part 329

Administrative practice and procedure, Banks, banking, Federal Deposit Insurance Corporation, FDIC, Liquidity, Reporting and recordkeeping requirements.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR CHAPTER III

Authority and Issuance

For the reasons set forth in the supplementary information, the Federal Deposit Insurance Corporation proposes to amend 12 CFR chapter III parts 324 and 329 to read as follows:

PART 324—CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS

- 1. The authority citation for part 324 continues to read as follows:

AUTHORITY: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).

■ 2. Amend § 324.2 by:

a. Revising the definitions of “Collateral agreement,” “Eligible margin loan,” “Qualifying master netting agreement,” and “Repo-style transaction”; and

b. Renumbering the remaining footnotes throughout the part.

The revisions read as follows:

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Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a FDIC-supervised institution for a single financial contract or for all financial contracts in a netting set and confers upon the FDIC-supervised institution a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the FDIC-supervised institution with a right to close out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral

agreement. A contract would not satisfy this requirement if the FDIC-supervised institution's exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(1) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar⁴ to the U.S. laws referenced in this paragraph (1) in order to facilitate the orderly resolution of the defaulting counterparty; or

(2) Where the agreement is subject by its terms to any of the laws referenced in paragraph (1) of this definition.

* * * * *

Eligible margin loan means:

(1) An extension of credit where:

(i) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(ii) The collateral is marked to fair value daily, and the transaction is subject to daily margin maintenance requirements; and

(iii) The extension of credit is conducted under an agreement that provides the FDIC-supervised institution the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided

⁴ The FDIC expects to evaluate jointly with the Board and OCC whether foreign special resolution regimes meet the requirements of this proposed rule.

under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar⁵ to the U.S. laws referenced in this paragraph in order to facilitate the orderly resolution of the defaulting counterparty.

(2) In order to recognize an exposure as an eligible margin loan for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(b) with respect to that exposure.

* * * * *

Qualifying master netting agreement means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, insolvency, conservatorship, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the FDIC-supervised institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or

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laws of foreign jurisdictions that are substantially similar⁶ to the U.S. laws referenced in this paragraph (i) in order to facilitate the orderly resolution of the defaulting counterparty; or

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a FDIC-supervised institution must comply with the requirements of § 324.3(d) with respect to that agreement.

* * * * *

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the FDIC-supervised institution acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

⁶ The FDIC expects to evaluate jointly with the Board and OCC whether foreign special resolution regimes meet the requirements of this proposed rule.

(2) The transaction is marked-to-fair value daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a “securities contract” or “repurchase agreement” under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the FDIC-supervised institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar⁷ to the U.S. laws referenced in this paragraph in order to facilitate the orderly resolution of the defaulting counterparty; or

(B) The transaction is:

(1) Either overnight or unconditionally cancelable at any time by the FDIC-supervised institution; and

(2) Executed under an agreement that provides the FDIC-supervised institution the rights to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of counterparty default.

(4) In order to recognize an exposure as a repo-style transaction for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of § 324.3(e) of this part with respect to that exposure.

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⁷ The FDIC expects to evaluate jointly with the Board, FDIC, and OCC whether foreign special resolution regimes meet the requirements of this proposed rule.

PART 329—LIQUIDITY RISK MEASUREMENT STANDARDS

- 3. The authority citation for part 329 continues to read as follows:

AUTHORITY: 12 U.S.C. 1815, 1816, 1818, 1819, 1828, 1831p–1, 5412.

- 4. Amend § 329.3 by revising the definition of “Qualifying master netting agreement” and renumbering the remaining footnotes throughout the part to read as follows:

§ 329.3 Definitions.

* * * * *

Qualifying master netting agreement means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, insolvency, conservatorship, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the FDIC-supervised institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided

that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar¹ to the U.S. laws referenced in this paragraph (2)(i) in order to facilitate the orderly resolution of the defaulting counterparty; or

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a FDIC-supervised institution must comply with the requirements of § 329.4(a) with respect to that agreement.

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By order of the Board of Directors of the Federal Deposit Insurance Corporation

Dated: January 21, 2015.

¹ The FDIC expects to evaluate jointly with the Board and OCC whether foreign special resolution regimes meet the requirements of this proposed rule.

Robert E. Feldman
Executive Secretary.

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